

SUMMARY ANALYSIS OF AMENDED BILL

Author: Machado Analyst: Colin Stevens Bill Number: AB 2221

Related Bills: _____ Telephone: 845-3036 Amended Date: 3/30/98

Attorney: Doug Bramhall

Sponsor: _____

SUBJECT: Internet Service Provider Tiering, Filtering or Gateway Scanning Device Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended MARCH 9, 1998.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED MARCH 9, 1998, STILL APPLIES.

OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and Bank and the Corporation Tax Law (B&CTL), this bill would allow a credit to taxpayers who are Internet service providers (ISP) equal to the total cost paid or incurred by the taxpayer for the purchase and installation of a tiering or filtering system, or a gateway scanning device, as defined, that is placed on the ISP's network.

SUMMARY OF AMENDMENT

Under the PITL and the B&CTL, the March 30, 1998, amendments would:

- Delete the definition of filtering system and instead add filtering system to the definition of tiering system;
- Expand the definition of a tiering or filtering system to include computer hardware as well as software;
- Expand the credit to include a gateway scanning device as an eligible cost;
- Define an "Internet Service Provider" and "Internet."

Except for the changes discussed above, the new revenue analysis, two additional policy considerations, the resolution of the implementation consideration regarding the bill's prior failure to require that providing Internet access be part of a taxpayer's business, and the revised implementation considerations

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

☐ S ☐ O
☐ SA ☐ OUA
☐ N ☐ NP
☐ NA ☐ NAR
☒ X PENDING

Agency Secretary Position:

☐ S ☐ O
☐ SA ☐ OUA
☐ N ☐ NP
☐ NA ☐ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved _____
Position Disapproved _____
Position Noted _____

Department/Legislative Director Date
Johnnie Lou Rosas **4/7/98**

Agency Secretary Date

By: _____ Date: _____

discussed below, the remainder of the department's analysis of the bill as introduced February 19, 1998, still applies.

Policy Considerations

The tax credit does not contain a sunset date. Sunset dates generally are provided to allow periodic review of credits by the Legislature.

This bill would allow a credit equal to 100% of identified costs for taxpayers who purchase and install tiering or filtering software. A 100% credit is unprecedented as a matter of tax policy.

As written, this bill would allow a credit to ISPs located in California as well as those outside the state and would allow national and worldwide ISP's to receive a credit equal to 100% of all qualifying expenses incurred nationally and worldwide.

Implementation Considerations

Department staff is working with the author's office to resolve the implementation issues identified in this analysis.

The March 30, 1998, amendments define the "Internet," and "Internet service provider," remove the term "web server" and provide clarification on the terms "tiering or filtering system." However, further clarification of the types of expenditures that would qualify as "hardware" and of the definition for a "server" would help to ensure that disputes do not arise between taxpayers claiming the credit and the department as to who can claim the credit and qualifying expenditures.

Technical Considerations

This bill would allow a credit equal to 50% of the cost of the software or device in the year installed, and 50% in the immediately succeeding year and also allow an eight-year carryover period. It is unclear whether the carryover period would begin after the first or the second year the credit is allowed, or whether carryover from the first year would be combined with the carryover from the second year. The author's staff has requested amendments 1-4 to clarify that carryover would be allowed for eight years and to allow 100% of the qualifying costs to be taken as a credit in the year that the costs are paid or incurred.

FISCAL IMPACT

Tax Revenue Estimate

The revenue losses of this bill are unknown at this time, but probably would be in excess of \$100 million annually.

Tax Revenue Discussion

Revenue losses under this bill would depend on the number of ISPs that purchase and install a tiering or filtering system, or a gateway scanning

device, the cost of that system, and the ability of the ISP to apply credits generated.

According to industry sources, costs for a tiering or filtering system or a gateway scanning device can vary significantly depending on the number of users and the type and degree of filtering offered. These costs can range from \$3,000 to as much as \$1 million or more. It is expected that many larger ISPs, primarily national and worldwide ISPs, would develop much of their own software and that qualifying expenses would primarily be for the purchase of additional equipment for the systems.

As written, the credit is not limited to expenses incurred at the point of presence (assumed to be California presence) and would enable national and worldwide ISP's to receive 100% credit for all qualifying expenses incurred nationally and worldwide. Credits generated by national and worldwide ISPs could be used to offset California tax liabilities. There are an estimated 70,000 web servers worldwide growing at a rate of 6,000 per month. Additionally, it is projected that more than 50 million computers worldwide are connected to the Internet, with the number growing at the rate of over 3 million per month. Since the credit allowed by this bill would be equal to 100% of the cost for a tiering or filtering system or a gateway scanning device, annual revenue losses could potentially be in the hundreds of millions of dollars.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2221
As Amended March 30, 1998

AMENDMENT 1

On page 2, strike lines 8-17 and insert:

to the costs paid or incurred during the taxable year by the taxpayer for the purchase and installation of a tiering or filtering system, or a gateway scanning device.

AMENDMENT 2

On page 3, strike lines 31-35 and insert:

(f) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and the succeeding seven years if necessary, or until the credit is exhausted, whichever occurs first.

AMENDMENT 3

On page 4, strike lines 1-10 and insert:

costs paid or incurred during the income year by the taxpayer for the purchase and installation of a tiering or filtering system, or a gateway scanning device.

AMENDMENT 4

On page 5, strike lines 23-27 and insert:

(f) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and the succeeding seven years if necessary, or until the credit is exhausted, whichever occurs first.